2.4 HOLDING COMPANY

Where one company controls the management of another company the former is called the 'Holding Company' and the latter over which the control is exercised is termed as a 'Subsidiary Company'.

Holding Company

A holding company is a parent company that owns enough voting stock (more than 50%) in a subsidiary to make management decisions, influence and control the company's board of directors.

However, holding companies that control 80% or more of the subsidiary's voting stock gain the benefits of tax consolidation, which include tax-free dividends for the parent company and the ability to share operating losses.

Subsidiary Company

A subsidiary is a company that is controlled by a holding company or parent; this means at least 50% of its stock is controlled by another company. This 50% or greater stake gives the parent company control.

Meaning of "holding company" and "subsidiary". (Sec.-4)

(1) For the purposes of this Act, a company shall, subject to the provisions of sub-section (3), be deemed to be a subsidiary of another if, but only if,

- (a) That other controls the composition of its Board of directors; or
- (b) That other :
  - (i) where the first-mentioned company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company.
  - (ii) where the first-mentioned company is any other company, holds more than half in nominal value of its equity share capital ; or
- (c) The first-mentioned company is a subsidiary of any company which is that other's subsidiary.

Advantage of Holding Company

- Separate Identity
- Limited Size and Efficient Control
- Elimination of Competition
- Convenience in price control
- Separate Published Accounts
- Divesting Control and Management of Holding company
- Increase in capital resources of the subsidiary company

Disadvantage of Holding Company

- Decision of holding company – a hurdle
- More profits to the holding company
- Interest of the minor shareholders not secure
- More remuneration to the Directors of holding company
- Difficulty in valuation of inter – company stock

Consolidated Financial Statement (AS 21)

This standard must be applied when accounting for investment in subsidiaries in a separate financial statement of the parent.

It is to be noted that while preparing a consolidated financial statement, other standards also stay relevant in a similar manner as for standalone statements.

This accounting standard doesn't deal with :

- accounting methods for amalgamations and effects on consolidation, which includes goodwill which arises on amalgamation
- accounting for investments in JVs (joint ventures)
- accounting for investments in associates

Presentation of Consolidated Financial Statements

A parent company presenting its consolidated financial statements must present these statements along with its standalone financial statements.

The users of financial statements of a parent company are typically concerned with and are required to be educated about, the results of operations and financial position of not only the company itself but also of that group together.

This requirement is served by offering the users of financial statements :

(a) Standalone financial statements of a parent; and

(b) Consolidated financial statements that provide financial information about the business group as that of a lone enterprise without respect to the legal restrictions of the distinct legal entities

Scope of Consolidated Financial Statements

A parent company which presents its consolidated financial statements must consolidate all of its subsidiaries, foreign as well as domestic. Where a company doesn't have any subsidiary, however, has associates and/or joint ventures such company also needs to prepare consolidated financial statements as per Accounting Standard 23 – Accounting for Associates in Consolidated Financial Statements and Accounting Standard 27 – Financial Reporting of Interests in JVs respectively.

Disclosures in the Financial Statements

Following disclosures must be made w.r.t. AS 21 Consolidated Financial Statements :

(a) In the consolidated financial statements the list of all the subsidiaries of the parent company which includes the name, country of residence or incorporation, the share of ownership interest and, in case different, the share of voting power held

(b) In case the consolidation of particular subsidiary hasn't been made according to the grounds permissible in the accounting standard, reasons for which such subsidiary isn't included in the consolidation must be disclosed in such consolidated financial statements

(c) In the consolidated financial statements, where valid:

  (i) Type of relationship between a parent and its subsidiary, whether direct control or indirect control through the subsidiaries

  (ii) Effect of acquisition and disposal of the subsidiaries on financial position at the date of reporting results for the reporting period and on corresponding amounts for preceding period; and

  (iii) Name of the subsidiary(s) of which reporting date(s) is different

Determine of Pre-Acquisition and Post-Acquisition Profit

Undistributed profit for all the financial year prior to that in which the holding company purchases the share in subsidiary company are considered as pre acquisition profits. Profits for the financial year

in which the shares in subsidiary profits are purchased are divided into two parts (Pre- acquisition profits and post- acquisition Profits) as per following rules.

- If the holding company has purchased the shares in its subsidiary on the date of beginning of the financial year of that company, then the whole profit for that financial year will be considered as 'post –acquisition Profit'
- If the holding company has purchased shares in the subsidiary on the last date of the financial year of that company then whole profit for that finical year will be considered as "pre- acquisition profit'
- If the holding company purchased shares in the subsidiary company on any date other than the date of beginning or the end of financial year of that company the whole profit for that financial year will be divided into two parts in the ratio of time period or of the sales (if known) part of the profit pertaining to the period prior to the date of acquisition of the shares will be considered as 'pre –acquisition profit and the part which pertains to the period after the said date will be considered as 'post acquisition Profit'

Accounting in The Books of Holding Company

When whole amount of dividend received is from the post- acquisition profits of the subsidiary :

Cash a/c Dr.

To Dividend a/c (Whole amount divided)

When whole amount of dividend received is from the pre-acquisition profit of the subsidiary company:

Cash a/c Dr.

To Investment in shares of ltd. ….a/c

With this journal entry the cost price of the investment already shown in the investment account will be diminished.

When the amount of dividend received is partly from pre –acquisition profits and partly from post - acquisition profits:

Cash a/c Dr.	(whole amount)
To dividend	(Amount received out of post –acquisition profits)
To investment in shares of ltd. ….a/c	(Amount received out of pre – acquisition profits)
Dividend a/c Dr.	
To Statement of profit and loss	(transfer entry)

A consolidated profit and loss account is prepared so that shareholders and other interested parties can see the results of the group for a period as though it were a single entity. It will also show how much of the profit accrues to the shareholders of the parent company and how much to the minority and how the directors will distribute the profit accruing to the shareholders.

How to Prepare Consolidated Financial Statements

A parent company which is not a wholly-owned subsidiary must publish :

- Its own balance sheet
- A consolidated balance sheet
- Its own profit and loss account
- A consolidated profit and loss account

Consolidated Balance Sheet

Under Indian Company Act, there is no need to prepare combined or consolidated final accounts of holding and subsidiary company in the books of holding company but holding company attaches the copy of balance sheet, one copy of profit and loss account and one copy of audit report of subsidiary

company with his final accounts. But for showing true financial position, often holding company prepare consolidated balance sheet.

It is easy to understand that consolidated balance sheet is a balance sheet in which all the assets and liabilities of holding company and subsidiary company are added with each other but practically, it is tough to make consolidated balance sheet of holding and subsidiary company.

Wholly Owned Subsidiary Company : When all the shares issued by a company are held in the control of another company. The former is known as a "wholly – owned subsidiary company.

Partly Owned Subsidiary Company : When more than half of the shares issued by a company are held in the control of another company and the remaining shares are owned by outside persons the former company is known as partly owned subsidiary company'

Steps for preparing consolidated balance Sheet of the holding company and its subsidiary-company :

1. Calculation of Net worth of Subsidiary of Company : Add all the assets of subsidiary company with the assets of holding company. But Investment of holding company in Subsidiary company will not show in consolidated balance sheet because, investment in subsidiary company will automatically adjust with the amount of share capital of subsidiary company in holding company.

Add all the liabilities of subsidiary company with the liabilities of holding company. But Share capital of subsidiary company in holding company will not show in the consolidated balance sheet in the books of holding company. Because this share capital automatically adjust with the amount of the investment of holding company in to subsidiary company.

2. Calculate cost of capital / Goodwill or Capital Reserve : If holding company purchases shares of subsidiary company at premium, then the value of premium will be deemed as goodwill or cost of capital and shows as goodwill on the assets side of consolidated balance sheet.

But if holding company purchases the shares of subsidiary company at discount, then this value of discount will be capital reserve and show in the liability side of consolidated balance sheet.

3. Calculate of Minority Interest : Minority interest is the shareholder but there is not holding company's shareholder. So, when holding company shows consolidated balance sheet, it is the duty of accountant to show minority interest in the liability side of consolidated balance sheet.

We can calculate minority interest with following formula

Total share capital of Subsidiary company = XXXXX
Less Investment of Holding company in to subsidiary company = - XXXX

Add proportionate share of the subsidiary company's profit and
Reserves or increase in the value of assets + XXXX

Less proportionate share of the subsidiary company's loss and decrease
In the value of total assets of company - XXXXX

Value of Minority Interest XXXXX

4. Pre – Acquisition of Reserve and Profit : Pre – acquisition profit and reserve of subsidiary company will be shown as capital reserve in consolidated balance sheet but the value of minority interest's profit or reserves deducts from it and add in minority interest value.

Total profit before acquisition of subsidiary company = XXXX
Less share of minority interest - XXXX
Value of profit X minority interest's value of shares in subsidiary company / total share capital of subsidiary company.

Pre – acquisition profit and reserve shown as capital reserve XXX

5. Calculate Post-Acquisition Profits : After the date of purchasing the shares of subsidiary company, profit of subsidiary company will also deem of holding company and it include in the profit of holding company and we also separate the part of profit of minority interest and add in minority interest's value and shown in liability side.

6. Elimination of Common Transactions : All common transaction between holding company and subsidiary company will not show in the consolidated balance. There following common transaction :

(i) Goods sold and goods purchase on credit and the value of debtor or creditor either subsidiary company or holding company will not show in consolidated balance sheet

(ii) Value of bill payable or bill receivable of holding company on subsidiary company will also not shown but if some bills value is discounted from third party then either of both company's payable value shown as liability in the consolidated balance sheet.

7. Treatment of Unrealized Profit : If subsidiary company sells the goods to holding company or holding company sells the goods to subsidiary company at profit and if such goods will not sold in third party, then the profit will not realized, so such unrealized profit will not credited to profit and loss account. At this time a stock reserve account is opened and all amounts of unrealized profit transfers to this account and this accounts total amount is deducted from closing stock of consolidated balance sheet.

Suppose

Closing stock of H 50000 + Closing stock of S 50000 =	1,00,000
Less stock reserve	2,000
	98,000

If subsidiary company has also other outsider's shares, then holding company makes reserve up to his shares proportion.

8. Treatment of Dividends : If holding company gets the dividends from subsidiary company, then this will divide into two parts. If subsidiary company declare dividend out of capital profits, then this will add in capital reserves in consolidated balance sheet. But, if subsidiary company has declared the profit out of revenue gains, then this dividend will add in general profit and loss account and will show in the liability side of consolidated balance sheet.

Example : X Ltd. purchased 750 shares in Y Ltd. on 1.7.2006. The following were their Balance Sheets on 31.12.2006.

Liabilities	X Ltd.	Y Ltd.	Assets	X Ltd.	Y Ltd.
	Rs.	Rs.		Rs.	Rs.
Share Capital :			Buildings	2,05,000	1,25,000
Shares of Rs. 100 each	3,00,000	1,00,000	Stock	1,00,000	80,000
General Reserve			Debtors	1,00,000	40,000
1.1.2006	1,00,000	70,000	Investment	1,00,000	–
Profit & Loss A/c	1,00,000	60,000	(in Y Ltd.)		
Creditors	80,000	40,000	Bills Receivable	40,000	45,000
Bills Payable	50,000	20,000	Bank	60,000	20,000
Current Account :			Current Accounts :		
X Ltd.	–	20,000	Y Ltd.	25,000	–
	6,30,000	3,10,000		6,30,000	3,10,000

Further

1. Bills Receivable of X Ltd. include Rs. 10,000 accepted by Y Ltd.
2. Debtors of X Ltd. include Rs. 20,000 payable by Y Ltd.

3. A cheque of Rs. 5,000 sent by Y Ltd. on 20th December was not yet received by X Ltd. till 31st December 2006.

4. Profit and Loss Account of Y Ltd. showed a balance of Rs. 20,000 on 1st January 2006.

You are required to prepare a consolidated Balance sheet of X Ltd. and Y Ltd. as on 31st December 2006.

1. Capital Profit :

General Reserve of Y Ltd. on 1.1.2006		Rs.	70,000
Add :	Profit and Loss A/c of Y Ltd. 1.1.2006	Rs.	20,000
	Current year's capital profit		
	Rs. 40,000 × 6/12	Rs.	20,000
	Capital Profit :		1,10,000

Holding Company's share Rs. 1,10,000 × 3/4 = 82,500

Minority's Share Rs. 1,10,000 × 3/4 = 27,500

2. Minority Interest :

Face value of Minority shares Rs. 100 × 250		Rs.	25,000
Add :	Minority share of capital profit		27,500
	Minority share of revenue profit		5,000
	Minority Interest :		57,500

3. Cost of Control or Goodwill :

Amount paid by X Ltd. for shares in Y Ltd.	Rs.	1,00,000
Less : Face value of shares : 750 × Rs. 100 :	Rs.	75,000
Holding Co's. share of Capital		82,500
Profit		1,57,500
Capital Reserve		57,500